83-59
No. 82-

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1982

American International Coal Co., Inc., Petitioner,

v.

Commissioner of Internal Revenue, Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Roy J. Roscoe
400 Manordale Road
Pittsburgh, PA 15241
(412) 835-7346
Counsel for the Petitioner

QUESTIONS PRESENTED

1. Whether the petitioner was entitled to deduct on its corporate federal income tax return commissions paid to a salary employee for services rendered, which produced substantial sales and profits for the petitioner.

2. Whether the court of appeals erred in affirming the tax court's decision setting aside a termination agreement characterizing a $50,000 payment by the petitioner to the terminating employee, a fifty percent shareholder, as compensation for services rendered when the lower court in its own language recognized and admitted the valuable nature of the employee's services, but held that the employee's services solely increased the value of the petitioner's stock and the employee was not entitled to any additional compensation for the

services other than his salary of $8,600 at the time of termination.

3. Whether the U. S. Treasury should be unjustly enriched by the inconsistent position of the Commissioner of the Internal Revenue in this case, to wit, collecting revenue from the petitioner by claiming a disallowance of a compensation payment after it has already collected revenue from the employee treating it as a compensation payment for Federal income tax purposes.

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IN THE

Supreme Court of the United States

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No. 82-

American International Coal Co., Inc., Petitioner,

v.

Commissioner of Internal Revenue, Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Petitioner, American International Coal Co., Inc., prays that a writ of certiorari issue to review a judgment of the United States Court of Appeals for the Third Circuit affirming a judgment of the United States Tax Court.

OPINIONS BELOW

The Judgment Order and Sur Petition for Rehearing of the United States Court of Appeals for the Third Circuit are not yet reported; they are set forth as Appendix A and B respectively, infra pp. 1a thru 4a. The opinion of the Tax Court is reported at 43 TCM 1097; Dec. 38, 947(m); T.C. Memo 1982-204.

JURISDICTION

The judgment by the United States Court of Appeals for the Third Circuit was entered on March 8, 1983. (Appendix A, infra. pages 1a and 2a). On March 31, 1983, the Court of Appeals denied a timely petition for rehearing (Appendix B, infra pages 3a and 4a. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

STATUTE INVOLVED

Section 162(a)(1) of the Internal Revenue Code provides:

> (a) In General - There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including-
>
> > (1) A reasonable allowance for salaries or other compensation for personal services actually rendered.

STATEMENT

This case is not one of reasonableness of compensation but arises out of a Termination Agreement, dated October 3, 1975, a copy of which is set forth as Appendix C infra p. 5a, between American International Coal Co., Inc. ("American" or petitioner) a Pennsylvania corporation engaged in the coal brokering business in Pittsburgh, Pennsylvania and Stephen C. Levitt ("Levitt"), an employee and a fifty percent shareholder of American. At the time of termination, Levitt had received from American for services rendered monthly salary payments totaling $8,600 and was solely responsible for producing profits in excess of $100,000 in his capacity as president and chief executive officer of American. Levitt was essentially the only employee of

American. The terms of the agreement provided a $50,000 payment to Levitt as "payment of commissions due Employee for services rendered to Employer." Levitt was represented by legal counsel (Robert Cindrich) during the negotiations while American was represented by the other fifty percent shareholder, Richard C. Schomaker ("Schomaker"). There was not any evidence showing Levitt possessed any operating losses or other unusual tax attributes, which would render any tax allocation meaningless to him. Moreover, the Government was not losing any significant revenue as a result of the parties characterization of the payment. However, in using the judicial doctrine of the substance of a transaction prevails over the form of it, the Tax Court, (affirmed by the appellate

court) set aside the Termination Agreement and ruled that the $50,000 payment to Levitt represented a redemption of his fifty percent stock interest in American. The lower court so held even though the terms of the agreement were the result of arm's length bargaining between the parties, and the overall structure of the arrangement was dictated by a legal liability on the part of American to pay Levitt a commission as a result of rendered services which caused American to have increased sales and profits during the period of time Levitt was solely managing and operating the corporation. American was obligated and bound to pay the commissions even in absence of the written agreement.

During the first year of its operations in 1975, American was engaged only

in the business of supplying coal under contract, i.e., the brokering of coal. Profits of American were solely dependent upon the securing of contracts for the purchase of coal at a price greater than the costs and expenses of shipping coal directly from the suppliers to the users of coal. On March 20, 1975, West Penn Power Company ("West Penn"), a large utility company serving the Pittsburgh area and a user of coal, entered into a forty-five month contract with American to provide a certain quality of coal at a total contract price of $19,980.00. Levitt was principally responsible for the successful negotiation and execution of the coal contract on behalf of American. However, the coal contract was meaningless and worthless without the proper quantity and quality of coal. As

a result, Levitt spent numerous hours by himself in finding coal suppliers to ship the right type of coal to West Penn. He worked out in the fields every day buying coal, making arrangements, meeting coal miners and owners of the mine. Although Levitt experienced many problems with suppliers providing the correct quantity and quality of coal to West Penn, he was quite successful in producing the only profits for American which according to his calculations were in excess of $100,000 during the period of time from January 1975 until September 23, 1975, the day of Levitt's departure.

On September 23, 1975, Levitt was abruptly taken into protective custody under the federal witness protection program without an opportunity for either Schomaker or Levitt to make ar-

rangements for someone to succeed him. At that time, Levitt had received monthly salary payments totalling $8,600 and obviously wanted additional sums based upon his successful, but brief career with American. With this in mind, Levitt prepared a check for $50,000 payable to himself, drawn on American's bank account, labelled it on the check stub as "for the purchase of stock of Stephen C. Levitt" and had it presented to Schomaker for his countersignature. The check was not negotiable unless Schomaker also placed his signature on it. On the check stub, Levitt placed the words "For the purchase of the stock of Stephen C. Levitt." Levitt did not know at this time whether his interest in American should be characterized as commissions or stock although he understood the difference in

the tax consequences between the two.

Schomaker refused to sign the check and explained to the messenger that he did not know how to operate the Company at all. Later, in a brief private meeting, Schomaker told Levitt that he could not sign the $50,000 check "the way it was." Levitt did not object but responded by saying that his attorney, Robert Cindrich would conclude the negotiations for terminating Levitt's interest in American. On Cindrich's advice, Levitt executed a general power of attorney authorizing his brother-in-law, Richard M. Handler ("Handler") to handle all of his financial affairs.

Subsequently, Cindrich and Schomaker met to discuss the terms of the withdrawal of Levitt as an employee and shareholder of American. Schomaker's

position was that since Levitt was solely responsible for the net profits of in excess of $100,000 and assets of American at the time of his departure, he was entitled to commission compensation for these valuable services which were responsible for the only sales and profits of American. Moreover, the West Penn coal contract, the principal source of revenue for American during Levitt's career with American, was an executory contract in that the right coal had to be found for shipment by suppliers, which was a serious problem when Levitt was solely operating the Company. The West Penn coal contract had contingent value, which at the time of Levitt's termination of services was not only unascertainable but also of little value, if any, because of the lack of an exper-

ienced successor to Levitt. Levitt recognized the limited and nominal value of the West Penn contract when he only wanted $50,000 based upon American's cash position of "$100,000 plus" at the time he drew the check. He requested no additional sums for the future value of the contract.

Both Levitt and Schomaker had earlier manifested their intention of the manner of treating the services rendered by Levitt. Before the incorporation of American, a Pre-Incorporation Agreement, a copy of which is set forth as Appendix D, p. 9a, dated December 5, 1974 was entered into by Levitt, Schomaker and another party who shortly thereafter was not associated with American. Article 3 of the agreement provided that:

> "If any party to the Agreement performs services in excess of

> those services rendered by the other shareholders, he shall be compensated on a reasonable basis in addition to his proportion of the net profits."

This agreement was still in effect at the time of Levitt's termination.

Final negotiations on terms of the Termination Agreement began on or about September 25, 1975 and ended on October 3, 1975. Intensive discussions about all terms of the arrangement were carried on between Schomaker and Cindrich. Moreover, although Cindrich and Handler had authority to negotiate Levitt's withdrawal as an employee-shareholder of American, Cindrich communicated Schomaker's offer to Levitt, who did not complain about the characterization of the payments as commissions and was satisfied with the characterization even though Cindrich advised him that the payment was to be reported

for tax purposes as ordinary income. Final approval was granted by Levitt, which paved the way for Cindrich to draft two documents, one entitled "Termination Agreement" characterizing the $50,000 payment as compensation for services rendered and the other "Agreement of Sale", a copy of which is set forth as Appendix E, p.12a providing for a redemption of Levitt's fifty percent stock interest for one thousand dollars.

The Termination Agreement, dated October 3, 1975, describes in the preamble that Levitt was previously employed by American as President, General Manager, and Sales Representative and had "consummated various sales of coal...which resulted in earnings and profit" to American. The language continues by averring that Levitt "is entitled to commissions on

said sales as set forth herein..." Paragraph number one provides for a $50,000 payment to Levitt for services rendered to American and paragraph three asserts that Levitt accepted the sum "as full and complete satisfaction of any and all amounts due to him...for services rendered in connection with Employer's (American's) coal brokerage business."

On October 3, 1975, these two agreements were signed by Schomaker on behalf of American and by Handler on behalf of Levitt. On or about the same day, Schomaker then countersigned the $50,000 check originally prepared by Levitt. Upon countersigning it, he changed the notation on the check stub by crossing out the words "for the purchase of the stock of Stephen C. Levitt" and substituted the word "commissions". In addition, Schomaker crossed out the original entry

in American's check register for the check under a column headed "in payment of" in which Levitt had entered "purchase of stock", and he inserted the word "commissions". He then delivered the check to Cindrich for transmittal to Levitt.

American prepared a form 1099 showing commission payments of $54,800 to Levitt as commissions and sent copies to the Government and Levitt. (The $54,800 represents the $50,000 check payment to Levitt plus $4,800 of consulting payments made to Levitt after his departure, which are not in issue in this appeal).

Years after the execution of the Termination Agreement, Levitt confirmed and verified his understanding of the characterization of the $50,000 payment. Pursuant to a request by the Commissioner, Levitt executed a Certificate

dated March 28, 1979 establishing that he believed that the payments in question to him were ordinary commissions taxed at ordinary income tax rates and not for payment of stock. Moreover, a supplemental certificate signed by Levitt on March 24, 1980, explains that the $50,000 payment received by him from American in 1975 was reported on his 1975 Federal Individual Income Tax Return Schedule C as ordinary income and not as capital gain. The Internal Revenue Service has accepted the 1975 tax return of Levitt with respect to the characterization of the payments as commissions under the terms of the Termination Agreement. Moreover, Levitt has never filed for or received a refund of taxes from the Treasury for the Commissioner's inconsistent position

that the payments represent a redemption of stock subject to taxation at capital gains rate, and the period of time has expired for Levitt to file a refund for the 1975 taxes paid to the Federal Government.

After Levitt's departure, Schomaker all but abandoned his law practice and devoted most of his time to the conduct of American's business. Schomaker was very inexperienced in the coal brokering business and did not know of anyone else in the coal business at the time of Levitt's departure or during the negotiations of the contract with Cindrich or shortly thereafter who could aid or assist him in the operations of American. Schomaker had nothing to do with any of the profits of American when Levitt was the Chief Executive Officer and respons-

ible for the day-to-day operations of American.

As a result of Schomaker's inexperience in the coal business, American eventually had to employ Jack Sedlack ("Sedlack") in November, 1975. Sedlack had some background in the coal business and assisted in managing American's business operations with Schomaker.

At the time of Levitt's departure, there were six suppliers furnishing coal to West Penn under the coal contract, all as a result of Levitt's efforts. By January, 1976, of these six suppliers, there was only one remaining supplier shipping coal. After Schomaker assumed the responsibility for the operations of American, the profits were down for the remaining parts of the 1975 calendar year. In fact, the income state-

ment for 1975 showed a loss for that year even though Schomaker worked vigorously to keep the company viable with the help of Sedlack. On its income tax return for 1975, American deducted the $50,000 payment to Levitt as commissions, which the Commissioner disallowed.

In holding that the Termination Agreement and Agreement of Sale do not reflect the substance and reality of the transaction, the lower court found the nature of the $50,000 payments to Levitt to be a redemption for his 1000 shares of American stock.

The lower court recognized the existence and valuable nature of Levitt's services and never denied that they occurred.

> "Many of the facts cited by petitioner (American) to show the value of Levitt's services, however, tend also to show that petitioner's

> stock had substantial value when Levitt left Pittsburgh, and they indicate that most (if not all) of the payment called for in the Termination Agreement was, in fact, paid to redeem his stock."

Moreover, in reaching its decision, the court relied upon oral evidence of Levitt culled from the record which contradicted the terms of the written Termination Agreement and certificates supporting the characterization of the payment as commissions. In essence, the court relied upon its own perception of the transaction without any discussion or consideration of the undisputed facts supporting the terms of Termination Agreement. The court undertook its own evaluation of certain selected facts showing that American was a going concern corporation and had a valuable asset in the West Penn coal contract. Despite

clear findings to the contrary, it adopted the conclusion that since "this was the price he (Levitt) asked for his stock based on his knowledge of the company's assets and liabilities," the $50,000 payment was in redemption of stock.

The United States Court of Appeals for the Third Circuit without oral argument affirmed the decision of the Tax Court "essentially for the reasons appearing in the opinion of the Tax Court...and that the decision is supported by substantial evidence."

REASONS FOR GRANTING THE WRIT

1. The arrangement in this case was a realistic one motivated by valid business reasons made by the parties on an arm's length basis, and to meet legal requirements. There was no doubt that

Levitt rendered valuable services to American. Yet the lower court strikes it down on a retrospective determination that it was a sham and substitutes its own business judgment for that of the parties. This decision completely misapplies and misunderstands that judicial doctrine that the substance of a transaction rather than the form is the controlling consideration. In applying this principle, the court below refused to give any probative weight to the form of the transaction, which is contrary to the Supreme Court decision in the Frank Lyons Company v. U.S. case.[1] As Justice Blackmum stated some years ago:

> "Form does not have some weight and significance in tax law and

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[1] Frank Lyons Company v. U.S., 1978, 78-1 USTC, Para. 9370, reversing CA-8, 76-1 USTC Para. 9457, 536 F.2d, 746.

> the selection of one route over another to a desired end is often a critical choice and may serve validly to govern the tax effect of a transaction."[2]

The Justice reiterated this viewpoint for the Supreme Court in his written opinion for the majority in the Lyons case, supra, by concluding:

> "In short, we hold that where as here, there is a genuine multiple-party transaction with economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations and is not shaped solely by tax-avoidance features that have meaningless labels attached, the Government should honor the allocation of rights and duties effectuated by the parties."

Earlier in the decision, the Court also recognized that the form of a transaction

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[2]Idol v. Commissioner, 391 F.2d 647, 651 98th Cir. 1963).

should govern when there is objective evidence to support it:

> The Court has never regarded 'the simple expedient of drawing up papers'....as controlling for tax purposes when the objective economic realities are to the contrary. (See pp. 83,879 and 83,880)

Even though the Lyons case, supra, involved a three party sale leaseback transaction, the doctrine and principles in that case are applicable here.

In the present case, the lower court never addressed itself to its function under the substance versus form doctrine of examining the intention of the parties with respect to whether there were sufficient facts surrounding the services performed by Levitt to justify and support the conclusion that the $50,000 payment was for commissions under the terms of the Termination Agreement.

The record was replete with facts by both parties to the agreement establishing the extent, nature and quality of Levitt's services which support the $50,000 payment as compensation under the terms of the Agreement.

An examination of the Termination Agreement reveals that every recital was true in fact. Levitt was the "President, General Manager, and Sales Representative" who had in fact "consummated various sales of coal on behalf of American, resulting in earnings and profits to American," and was "entitled to commissions on said sales as set forth in the Agreement." Uncontradicted and unimpeached testimony by both Schomaker and Levitt at the time of trial established that Levitt served in such positions of responsibility for American and had rendered services by

effectuating coal sales, resulting in earnings and profits to American. It would naturally follow that he would be entitled to commissions for such sales. None of these factors was created or fabricated by the parties as in the typical sham transaction. Moreover, the court itself recognized the existence and value of Levitt's services when it claimed in its opinion that Levitt's services caused American's stock to have substantial value. If Levitt's services increased the value of American's stock, they obviously had to be valuable.

The court also refused to give any probative weight to the Pre-Incorporation Agreement dated December 5, 1974 which established an agreement between Levitt and Schomaker to provide additional compensation to a party performing

"services in excess of those services rendered by the other shareholder." This agreement established unequivocally the original intention and understanding of Levitt and Schomaker before any services were performed as to the manner of compensation in the event Levitt performed services in excess of those services performed by Schomaker. The court neglected to consider whatsoever as relevant any aspect of the Pre-Incorporation Agreement which was established over nine months before Levitt terminated services and the resulting Termination Agreement characterizing the payments as commissions.

In the typical sham transaction, facts are artificial and unsupported by objective evidence, causing the courts to invoke the substance versus form doctrine

to strike down the shape of the transaction. In the present case, the lower court erred in its application of the judicial doctrine by arbitrarily ignoring uncontroverted and objective facts supporting the terms of the Termination Agreement by the parties with competing tax interests characterizing the payments as compensation for services rendered. The Lyons case, supra, supports the viewpoint of the petitioner that provided there are "objective economic realities" present, the courts must abide by the shape given the transaction by the parties, particularly when there is not any evidence that the Treasury is losing meaningful revenue from the characterization or allocation agreed to by the parties. Here, there was not any showing by the Commissioner that the

parties were subject to tax at substantially different tax rates or that the Treasury was deprived of revenues from the manner the parties characterize the payment.

For the lower court to say that nevertheless the $50,000 payment was in redemption of Levitt stock interest in American in support of the Commissioner's position, encourages the Internal Revenue Service's unwarranted interference in the business affairs of taxpayers by the substitution of its own business judgment for that of parties structuring a transaction even though the Service possesses less personal knowledge and information of the business deal, particularly values, than the parties. This practice should not be permitted to continue.

2. The lower court's decision in this case places businessmen under a cloud of uncertainty from a financial and strategic planning viewpoint and prevents them from forseeing with any accuracy the effect of the present transactions clearly. In pratically all business transactions, the income tax consequences are analyzed and considered in the determination of the net income result. With taxes often taking fifty percent of net income, taxpayers bargaining at arm's length, attempt to obtain the most favorable tax treatment on each transaction, which is permissible and acceptable within the tax laws. Bracketed with the principle that substance prevails over form in taxation is the almost equally accepted rule that each taxpayer has the privilege of so

ordering his affairs to pay the least tax, and the correlative that one can cast a transaction in the one of several alternative forms which is most advantageous tax wise.[3] Litigation abounds in this area of the tax laws where characterization of a transaction by the parties like the one in the present case is not questioned by the parties but is attacked by the Internal Revenue Services. It is an appropriate function of this court to provide guidance and clarification in this area of the tax laws to the lower courts, lawyers and government officials who are engaged in the administration of the tax laws. This is particularly the case where the question

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[3]Helvering v. Gregory, (1934 CCH para 9180), 69 F.2d 809, 810 (2d Circuit 1934) affirmed (35-1 USTC para. 9043) 293U.S. 465.

is one of importance on which the business community and lawyers need light so that intelligent planning and implementing of transactions may occur on a basis of reasonable assurance without the inevitability of controversy and litigation in each transaction from the Internal Revenue Service.

In the present case, each party involved in the characterization of the $50,000 payment had conflicting tax interests. Levitt preferred an allocation of all payments to the purchase of stock with taxation of the gain at the favorable capital gains rate while American would be unable to receive a deduction unless the entire payments were allocated as compensation for the employment services of Levitt. The record lacks any evidence showing that

Levitt possessed any unusual tax attributes such as a net operating loss which would make any tax allocation meaningless to him. The parties considered the income tax consequences in bargaining for the price to be paid. If American had known that the $50,000 payment was not deductible (which is the result of the decision below), the price paid to Levitt would have been adjusted accordingly. To deny the deduction now places American in a trap and as explained in the next section produces a windfall for the federal government by the adoption of an inconsistent position. The understanding that the $50,000 payment could be deducted by American was a basis on which the negotiation between Schomaker and Levitt were conducted and transpired. The bargain negotiated

between the parties was completely changed from their intentions without any substantive justification.

The situation in the present case is comparable to that which existed in the sale and leaseback arrangements when this Court granted certiorari and decided Frank Lyon Company v. U.S., supra. After the Court clarified the basic principles, the decision substantially limited litigation and administrative controversy. In the absence of a clarifying decision by this Court, multiplication of litigation in the lower courts is inevitable and the thwarting of business plans can be expected to continue. Prognostication of how some court in the future will assess the manner of characterization which the parties have chosen does not make good

business sense and prevents plans from being prudently and carefully implemented according to the agreement of the parties.

3. The lower court's decision is so clearly erroneous that it departs from customary standards in the administration of justice and calls for correction by this court. Section 162 of the Internal Revenue Code specifically permits a deduction "for salaries or other compensation for personal services actually rendered." At the time of his termination of employment with American, Levitt had only received a salary of $8,600 for approximately nine and one-half months of part and full-time work. During the same time period, American showed current estimated profits in excess of $100,000 solely as a result of Levitt's services. Clearly, a

salary amount not commensurate with the positions of responsibilities and the value of his services. It should also be noted that high compensation is more reasonable when as in the present case there is a corresponding lack of fringe benefits, such as, pension plans or stock options, which might normally be expected.[4] Where the personal efforts of the major stockholder in a closely held corporation are responsible for its success, the law has long recognized that a larger salary for such person is appropriate.[5] The principal rule that pervades these cases emphasize that if

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[4]Cherokee Warehouses, Inc. v. Commissioner, 82-1 USTC para. 9186, 6th Cir.

[5]Gordy Tire Co. v. U.S., 296 F.2d 476 (Ct. Cl. 1961).

sales and profits are higher as the result of the time and efforts of an employee, a higher compensation is justified.

In the instant case, there can be no question but the valuable services were rendered by Levitt which justify the commission payments made to him under the terms of the Termination Agreement. The evidence unquestionably supports a finding that the transaction was bona fide and not tax motivated but entered into for other good and sufficient non-tax reasons. It was a valid business purpose for American characterizing the transaction as compensation for services rendered by Levitt. Under these circumstances, the lower court should not be permitted to rewrite the terms of the transaction and substitute

its business judgment as it has done in its opinion.

4. The inconsistent position taken by the Commissioner of Internal Revenue in the present case enables the Treasury to be unfairly and unjustly enriched. The decision of the lower court encourages the Commissioner to raise additional revenue by adopting inconsistent positions with respect to one party in a transaction or agreement similar to the one in this case without joining the other party to the litigation. In the present case, both parties to the Termination Agreement reported the transaction consistently on their respective tax returns. Levitt reported the $50,000 payment in 1975 on his federal income tax return as commissions subject to the maximum fifty percent income tax

rate on earned income while American deducted the payment of its 1975 corporate income tax return. The Treasury received the income taxes on the transaction from Levitt reporting the payment as income on his tax return. Now as a result of the affirmation of the Tax Court's decision by the Third Circuit Court of Appeals, it will again receive revenue from the same transaction but a different source, as a result of the Commissioner successfully arguing American's deduction was totally improper and represented a non-deductible redemption of stock.

If the Third Circuit prevents a taxpayer from using the tax laws to avoid the tax consequences of his agreement by taking an inconsistent position,[6] it

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[6] Danielson v. Commissioner (1967) 67-1 USTC para. 9423; 378 F.2d 771.

should treat all litigants equally and preclude the Commissioner from adopting inconsistent positions in cases like the present one. The rationale of the Danielson decision, supra, was to discourage taxpayers to litigate an allocation or characterization of a transaction, which was agreed to, by adopting an inconsistent position for tax purposes resulting in a loss of revenue to the federal government. However, equity and reason dictate that there be a correlation to the Danielson rule, namely, that the Commissioner cannot use the tax laws to unfairly and unjustly enrich the Treasury by treating a transaction differently and inconsistently as he has done in the present case. Consistency in this area of the law should not discriminate.

5. The Government will undoubtedly contend that this writ of certiorari requests this Court to evaluate facts, which on its face violates Rule 52(a) of the Rules of Civil Procedure, 28 U.S.C.A., which provides that findings by the trial court shall not be set aside "unless clearly erroneous."

"A finding is clearly erroneous when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed."[7] However, obeisance to the "clearly erroneous rule" must yield when the facts are undisputed and the Court

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[7] United States v. Gypsum Company, et al., 333 U.S. 364, 395, 68 S. Ct. 525, 542, 92 L. Ed. 746 (1948).

is then called upon to apply reason and interpretation.[8] Therefore, since the present case hinges on the interpretation and construction of contracts and on the legal characterization for federal tax purposes of the transaction between the parties, which is not a question of fact but rather one of law,[9] the Tax Court's decision relative to this case is not to be garrisoned by the clearly erroneous rule.[10] The issues on appeal are legal rather than factual. There is

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[8] American National Bank of Austin v. United States, 5 Cir., (70-1 USTC Para. 9184) 421 F.2d 442, 451 (1970).

[9] Waterman Steamship Corporation v. Commissioner of Internal Revenue, 5 Cir., (70-2 USTC Para. 9514) 430 F.2d 1185, 1192, cert. denied 401 U.S. 939, October Term, (1970).

[10] American National Bank of Austin v. United States, supra.

no dispute as to the facts as found by the Tax Court.

In a case concerning capital gain versus ordinary income arising out of the sale of subdivided real estate,[11] a Court of Appeals reversed a judgment of the District Court in favor of the taxpayer, saying that in the instant case the Trial Court found the basic facts which there was no disagreement, from which it concluded the ultimate fact that the holding was not primarily for sale in the ordinary course of the taxpayer's business. In weighing the arguments on this point, the Appeals Court recognized that the characterization of the taxpayer's manner of holding the

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[11] United States v. Winthrop, (1969, C.A. 5 Fla) 417 F.2d 905.

lands was a question of fact, but said that the District Court's finding on this ultimate issue is not to be garrisoned by the "clearly erroneous" rule. Though it has factual underpinnings, the Court points out, this ultimate issue is inherently a question of law and obedience to the "clearly erroneous" rule must yield when the facts are undisputed and an appellate court is called upon to reason and interpret; this is the law obligation of the Court as distinguished from its fact finding duties, and where the conclusion of the trial court as to an ultimate fact is merely a product of legal reasoning, that the conclusion is subject to appellate review free from the restraint of the "clearly erroneous" rule.

It should be noted also that to the extent there may be disagreements with respect to the inferences to be drawn therefrom, or with respect to "ultimate facts, the Third Circuit has ruled that the "clearly erroneous" standard is not applicable.[12]

In the present case, there was no dispute that Levitt performed services for American resulting in profits of in excess of $100,000 for the company. The lower court recognizes these services not to support or justify the $50,000 payment as compensation under the Termination Agreement but rather as a payment in

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[12] Soles v. Franzblau, 352 F.2d 47 (3d Cir. 1965), cert. denied, 383 U.S. 911 (1966); Kuhn v. Princess Lida of Thurn & Taxis, 119 F.2d 704 (3d Cir. 1941).

redemption of Levitt's fifty percent stock interest in American.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

Roy J. Roscoe
400 Manordale Road
Pittsburgh, PA 15241
Counsel for Petitioner

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 82-3410

AMERICAN INTERNATIONAL COAL CO., INC.

Appellant

v.

COMMISSIONER OF INTERNAL REVENUE

(Tax Court Docket No. 14574-79)

Submitted Under Third Circuit Rule 12(6)

March 7, 1983

BEFORE: SEITZ, Chief Judge, HIGGINBOTHAM and SLOVITER, Circuit Judges.

JUDGMENT ORDER

After consideration of the contentions raised by appellant and essentially for the reasons appearing in the opinion of the Tax Court (Tax Ct. Memo. Dec.

(P-H) para. 82,204) and our conclusion that the decision is supported by substantial evidenc, it is

ADJUDGED AND ORDERED that the decision of the Tax Court be and is hereby affirmed.

Costs taxed against appellant.

By the Court,

/s/ Seitz
Chief Judge

ATTEST:

/s/ Sally Mrvos
Sally Mrvos, Clerk

DATED: March 8, 1983

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 82-3410

AMERICAN INTERNATIONAL COAL CO., INC.,

Appellant

v.

COMMISSIONER OF INTERNAL REVENUE

(TAX COURT DOCKET NO. 14547-79)

SUR PETITION FOR REHEARING

PRESENT: SEITZ, Chief Judge, ADAMS, GIBBONS, HUNTER, WEIS, HIGGINBOTHAM, SLOVITER, BECKER, District Judges.

The petition for rehearing filed by Appellant in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for

rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By the Court,

/s/ Seitz
Collins J. Seitz
Chief Judge

Dated: March 31, 1983

TERMINATION AGREEMENT

THIS AGREEMENT, made this 3rd day of October, 1975, by and between RICHARD M. HANDLER, 1097A Fountain Lane, Columbus Ohio 43213, true and lawful attorney for STEPHEN C. LEVITT, formerly of 582 Clemson Drive, Mt. Lebanon, Pennsylvania, hereinafter referred to as "Employee,"

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AMERICAN INTERNATIONAL COAL CO., INC., a Pennsylvania corporation, hereinafter referred to as "Employer."

W I T N E S S E T H:

WHEREAS, Employee has been previously employed by Employer as President, General Manager and Sales Representation; and,

WHEREAS, Employer has been engaged in the business of coal brokering; and

WHEREAS, Employee has consummated various sales of coal on behalf of Employer which have resulted in earnings and profit to Employer; and

WHEREAS, Employee is entitled to commissions on said sales as set forth herein and is terminating his employment with Employer as of the 3rd day of October, 1975;

NOW, THEREFORE, intending to be legally bound hereby, the parties agree as follows:

1. On or before the 3rd day of October, 1975, Employer shall pay to Employee the sum of FIFTY THOUSAND ($50,000.00) DOLLARS in cash, certified or cashier's fund, which said sum shall be in partial payment of commissions due Employee for services rendered to Employer.

2. In addition to the sum of FIFTY THOUSAND ($50,000.00) DOLLARS as set forth in Paragraph 1, Employer shall pay to Employee the sum of TWELVE THOUSAND ($12,000.00) DOLLARS payable at the rate of TWO HUNDRED ($200.00) DOLLARS per week for each and every week, commencing on the week beginning Monday, October 6, 1975, without interest on unpaid principle balance due.

3. Employee agrees to accept the sum set forth in Paragraphs 1 and 2 as full and complete satisfaction of any and all amounts due to him from Employer for services rendered in connection with Employer's coal brokerage business.

4. RICHARD M. HANDLER covenants and warrants that he has full and complete right, power and authority to enter into the agreement set forth herein

pursuant to that certain Power of Attorney which is attached hereto as Exhibit "A".

5. The provisions of this agreement shall insure to the benefit of and by the successors and assigns of Employer and Employee and the executors, administrators, heirs, successors and assigns of all parties herein.

IN WITNESS WHEREOF, the parties have hereunto affixed their hands and seals the day and year first above written.

WITNESS: STEPHEN C. LEVITT

/s/Robert J. Cindrich by: /s/Richard M. Handler
Richard M. Handler

ATTEST: AMERICAN INTERNATIONAL COAL CO., INC.

/s/Richard C. Schomaker /s/Richard C. Schomaker
Secretary Richard C. Schomaker

AGREEMENT

THIS AGREEMENT made this 5th day of December, 1974, by STEPHEN LEVITT, ROBERT L. TODD, and RICHARD C. SCHOMAKER.

WHEREAS, the parties hereto desire to enter the coal mining and brokering business; and

WHEREAS, each of the parties hereto has already contributed important talents, business connections and efforts to various coal transactions;

NOW, THEREFORE, the parties hereto mutually covenant and agree as follows:

1. The parties hereto hereby agree to form the AMERICAN INTERNATIONAL COAL COMPANY, INC., a corporation, and/or any other appropriate entity or entities for the purposes of conducting a coal business, including coal mining and coal brokering.

2. Each party covenants to contribute all business contacts, contracts and any and all rights pertaining to coal to the corporation. However, the contracts previously arranged by Todd between Freehold Land and Mineral Company and the GCU and between Freehold Land and Mineral Company and the Eutsey Estate are excluded; all rights accruing to Todd under the aforementioned two contracts shall belong to Todd individually.

3. If any party to this Agreement performs services in excess of those services rendered by the other shareholders, he shall be compensated on a reasonable basis in addition to his proportion of the net profits.

4. All net profits, after expenses, shall be divided equally among the shareholders.

5. It shall be a prerequisite to this agreement that each shareholder enter either a post-nuptial or pre-nuptial agreement, whichever shall be appropriate, to the effect that the present wife or prospective spouse of the shareholder shall not be entitled to any interest in the corporation.

6. All business decisions of the corporation shall be made by a majority of the shareholders, all of whom shall be entitled to vote.

IN WITNESS WHEREOF, and intending to be legally bound, the parties hereto have executed this Preincorporation Agreement the day and year first above written.

WITNESS:

/s/Jane Green Davis — /s/Stephen C. Levitt (SEAL)
STEPHEN LEVITT

/s/Jane Green Davis — /s/Robert L. Todd (SEAL)
ROBERT L. TODD

/s/Jane Green Davis — /s/Richard C. Schomaker (SEAL)
RICHARD C. SCHOMAKER

AGREEMENT OF SALE

THIS AGREEMENT, made this 3rd day of October, 1975, by and between RICHARD M. HANDLER, 1097A Fountain Lane, Columbus Ohio 43213, true and lawful attorney for STEPHEN C. LEVITT, formerly of 582 Clemson Drive, Mt. Lebanon, Pittsburgh, Pennsylvania, hereinafter referred to as "Seller",

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AMERICAN INTERNATIONAL COAL CO., INC., a Pennsylvania corporation, hereinafter referred to as "Buyer."

W I T N E S S E T H:

WHEREAS, Buyer desires to purchase all of the outstanding common capital stock of AMERICAN INTERNATIONAL COAL CO., INC., owned by Seller; and

WHEREAS, Seller desires to sell and dispose of his stock in the said corporation at the price and on the terms hereinafter set forth; and

WHEREAS, STEPHEN C. LEVITT is the record owner of 1000 shares of common capital stock of AMERICAN INTERNATIONAL COAL CO., INC.; and

WHEREAS, by instrument dated September 26, 1975, a copy of which is attached hereto, designated Exhibit "A" and made a part hereof, and therein granted RICHARD M. HANDLER the power to sell, assign, transfer and dispose of any and all stock owned by STEPHEN C. LEVITT:

NOW, THEREFORE, intending to be legally bound hereby, the parties agree as follows:

1. Seller agrees to sell to Buyer and Buyer agrees to purchase from Seller

1000 shares of the common capital stock of AMERICAN INTERNATIONAL COAL CO., INC., a Pennsylvania corporation, at the price and upon the terms and conditions hereinafter set forth.

2. PURCHASE PRICE. The purchase price to be paid by Buyer to Seller for the said 1000 shares of common capital stock of AMERICAN INTERNATIONAL COAL CO., INC. shall be ONE THOUSAND ($1,000.00) DOLLARS, payable as set forth below:

A. On the date of closing as set forth hereinafter, Buyer shall surrender to Seller, Seller's promissory judgment note dated the 22nd day of December, 1974, in the amount of ONE THOUSAND ($1,000.00) DOLLARS marked cancelled and paid in full and Seller shall be relieved from any further responsibility to make payments of principle or interest on account of said note.

3. The delivery to Buyer of certificates for the shares of common capital stock sold hereunder by Seller and the payment of the purchase price as set forth above shall take place at the offices of the corporation on the 3rd day of October, 1975.

4. On said closing date, Seller shall deliver to Buyer the certificate evidencing the 1000 shares of common capital stock of AMERICAN INTERNATIONAL COAL CO., INC., agreed to be sold hereunder, duly endorsed for transfer.

5. WARRANTIES AND REPRESENTATIONS OF SELLER. Seller hereby warrants, represents and agrees to and with Buyer as follows:

A. Seller has full, complete and absolute title to the shares of stock to be transferred hereunder;

B. RICHARD M. HANDLER covenants and warrants that he has full and complete right, power and authority to make the sale and conveyance contemplated hereunder pursuant to that certain Power of Attorney which is attached hereto as Exhibit "A";

C. The title of the Seller to the said shares is free and clear of any lien, charge, or encumbrance and said shares, aggregating 1000 shares, constitute Fifty (50%) percent of all of the outstanding capital stock of the corporation, and by sale of said shares of stock hereunder, Buyer will receive good and absolute title thereto, free of any liens, charges or encumbrances thereon;

D. AMERICAN INTERNATIONAL COAL CO., INC., is a corporation duly organized and existing under and by virtue of

the laws of the Commonwealth of Pennsylvania and is in good standing under the laws of that state; said outstanding 1000 shares of capital stock of said corporation have heretofore duly been issued; all of said issued and outstanding shares are valid, fully paid and nonassessable, and no assessment is outstanding against the same or any part thereof; and, that all stock transfer restrictions affecting the transfer of said shares of capital stock to Buyer hereunder have been duly complied with or effectively waived by this Agreement, and that upon the closing hereunder, Buyer will have full and absolute title to said shares, free and clear of all liens, charges or encumbrances.

E. STEPHEN C. LEVITT, by his true and lawful attorney, RICHARD M. HANDLER, shall cause to be delivered to

Buyer, his written resignation as officer and director of the corporation;

F. The warranties, representations and agreements set forth herein shall be continuous and shall survive the delivery by Seller and the receipt by Buyer of the capital stock to be sold hereunder.

6. Seller hereby waives all preemptive rights and restrictions on the sale and transfer of the capital stock sold hereunder and agrees to hold Buyer harmless from and against all liability, loss, damage, or claims arising directly or indirectly from Buyer's failure to obtain hereunder absolute, entire and unconditional ownership of the capital stock of the corporation, free and clear of all restrictions. liens, charges or encumbrances.

7. The provisions of this Agreement shall inure to the benefit of and bind the successor and assigns of Seller and Buyer and the executors, administrators, heirs, successors and assigns of all parties herein.

IN WITNESS WHEREOF, the parties have hereunto affixed their hands and seals the day and year first above written.

WITNESS: STEPHEN C. LEVITT

_____ by: /s/Richard M. Handler
Richard M. Handler

ATTEST: AMERICAN INTERNATIONAL COAL CO., INC.

/s/Richard C. Schomaker
Secretary

by: /s/Richard C. Schomaker
President